US Government Takes Major Steps To Make Depositors Whole and Provide Liquidity

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This alert provides background on the failure of Silicon Valley Bank and explains significant recent developments, including the subsequent failure of Signature Bank and the U.S. government's announcement that the Federal Deposit Insurance Corporation (FDIC) will make whole all depositors of both institutions. This alert also describes the new program simultaneously announced by the Federal Reserve to provide additional liquidity to the banking industry.

Run on Silicon Valley Bank

Silicon Valley Bank (SVB) was one of the 20 largest banks in the United States with more than $200 billion of total assets. Its business model focused on servicing the technology and venture capital community. For this reason, a substantial portion of SVB's deposits were from clients who held deposits well in excess of the $250,000 maximum amount insured by the FDIC in the event of a bank failure.

On March 8, SVB's parent company publicly announced its intent to raise capital to help offset a loss of approximately $1.8 billion. This loss was generated by SVB's sale of a substantial portfolio of U.S. government and agency securities. Those securities had declined in value as a result of increases in the market interest rate environment.

Despite remaining well capitalized and having an asset base generally perceived as strong from a credit perspective, SVB experienced significant deposit outflows over the next day and a half. On March 9 alone, the bank's clients sought to withdraw more than $40 billion of deposits from the bank. This run on the bank left SVB with a negative cash balance and unable to satisfy further withdrawals.

Silicon Valley Bank Fails and FDIC Announces Initial Plan

On March 10, the FDIC was named receiver for SVB. The FDIC generally locked down the systems of SVB in an effort to prevent funds from flowing in or out of the bank. Clients were unable to access their funds or determine clearly the status of their accounts and pending transactions, including attempts to withdraw funds from the bank.

As receiver, the FDIC is responsible for resolving the bank's failure in a manner that is the "least-cost resolution" to the Deposit Insurance Fund. The Deposit Insurance Fund is administered by the FDIC and funded through regular assessments made on all banks. The FDIC is obligated to reimburse depositors the full amount of any deposits at a failed bank that are less than the legal insurance limit of $250,000. The extent to which uninsured deposits above that limit can be recovered depends on the structure, success and timing of the FDIC's sale or other resolution of the failed bank's assets.

In the case of SVB, the FDIC initially announced at the time of the failure that it would resolve the bank through a payout structure. The FDIC created a special purpose bank called the Deposit Insurance National Bank of Santa Clara for the purpose of giving clients prompt access and limited services with respect to the insured $250,000 portion of their deposits. The FDIC also announced that it would pay an "advance dividend" with respect to an unannounced and undetermined portion of the uninsured deposits "within the next week." Dividends for this purpose effectively represent cash distributions from the receivership of the failed bank. Any remaining dividends with respect to uninsured deposits would depend on whatever recoveries the FDIC might obtain by selling the bank's assets to one or more buyers or investors.

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This initial approach did not guarantee that clients of SVB would receive 100% of their uninsured deposits. It also generated significant uncertainty related to operational, process and timing matters. The speed with which SVB failed, together with the realization by business clients that the uninsured portion of their bank deposits could be at risk of loss, risked putting liquidity pressure on other banks as their clients began withdrawing deposits in favor of placing them at money center banks or into non-deposit products, such as money market mutual funds.

Government Announces That FDIC Will Make Whole All Depositors of SVB and Signature Bank

Late on Sunday, March 12, the FDIC, Board of Governors of the Federal Reserve System and the Department of the Treasury issued a joint statement addressing the failure of SVB and the subsequent failure of Signature Bank. Based in New York, Signature Bank had approximately $110 billion of total assets. The text of the joint statement is reproduced below.

> Today we are taking decisive actions to protect the U.S. economy by strengthening public confidence in our banking system. This step will ensure that the U.S. banking system continues to perform its vital roles of protecting deposits and providing access to credit to households and businesses in a manner that promotes strong and sustainable economic growth.
>
> After receiving a recommendation from the boards of the FDIC and the Federal Reserve, and consulting with the President, Secretary Yellen approved actions enabling the FDIC to complete its resolution of Silicon Valley Bank, Santa Clara, California, in a manner that fully protects all depositors. Depositors will have access to all of their money starting Monday, March 13. No losses associated with the resolution of Silicon Valley Bank will be borne by the taxpayer.
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> We are also announcing a similar systemic risk exception for Signature Bank, New York, New York, which was closed today by its state chartering authority. All depositors of this institution will be made whole. As with the resolution of Silicon Valley Bank, no losses will be borne by the taxpayer.
>
> Shareholders and certain unsecured debtholders will not be protected. Senior management has also been removed. Any losses to the Deposit Insurance Fund to support uninsured depositors will be recovered by a special assessment on banks, as required by law.
>
> Finally, the Federal Reserve Board on Sunday announced it will make available additional funding to eligible depository institutions to help assure banks have the ability to meet the needs of all their depositors.
>
> The U.S. banking system remains resilient and on a solid foundation, in large part due to reforms that were made after the financial crisis that ensured better safeguards for the banking industry. Those reforms combined with today's actions demonstrate our commitment to take the necessary steps to ensure that depositors' savings remain safe.

As a result of these governmental steps, the FDIC will now provide direct protection of 100% of the deposits that clients held at both institutions — *including the uninsured amounts*. This is a very significant development. The joint statement also indicates that clients will have access to all of their funds as of Monday, March 13.

We note that these measures relate only to the deposits held at SVB and Signature Bank. They do not involve the parent company of SVB, SVB Financial Group or the nonbank affiliates of either bank. Nonbank entities are generally not subject to FDIC receivership and are not covered by the measures described above. We also note that these measures do not address non-U.S. bank subsidiaries, which may be subject to the bank resolution regimes in their respective jurisdictions. For example, the Bank of England has moved to place Silicon Valley Bank UK Limited into the U.K. bank insolvency procedure.

Federal Reserve Announces Additional Liquidity Program for Banking Industry

Simultaneously with the joint statement described above, the Federal Reserve separately announced its creation of a bank term funding program. This new program will provide loans of up to one year to banks and other eligible depository institutions, which may be secured by pledging U.S. Treasuries, agency debt and mortgage-backed securities, and other qualifying assets as collateral. This new program will be in addition to the traditional Federal Reserve discount window, which remains open and available.

The Federal Reserve's new program is intended to provide additional liquidity to the U.S. banking system. In its announcement, the Federal Reserve stated that it is "prepared to address any liquidity pressures that may arise."